No. 89-1415

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

JAMES E. LINDSEY, *et al.*,

Petitioners,

v.

THE FERRIS FACULTY ASSOCIATION-MEA-NEA, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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PETITIONERS' REPLY BRIEF

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May 1990

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I. THE UNIONS' NOTION THAT A COMPULSORY FEE CAN BE INDEPENDENTLY AUDITED WITHOUT TESTING FOR LEGAL SUPPORT IGNORES *HUDSON*'S REQUIREMENT OF CAREFUL JUSTIFICATION AND THE ACCOUNTING EVIDENCE

Unions must meet procedural requirements to collect compulsory service fees, but not because there is a "potential for infringing on the First Amendment rights of nonmember employees," as Respondents' Brief in Opposition ("Opposition") at 8 suggests. Rather, "the agency shop *itself is* a 'significant impingement on First Amendment rights,'" and that fact "requires that the procedure be carefully tailored to *minimize* the infringement" that already exists. *Teachers Local 1 v. Hudson*, 475 U.S. 292, 303, 307 n.20 (1986) (emphasis added) (quoting *Ellis v. Railway Clerks*, 466 U.S. 435, 455 (1984)).

Respondent unions' misstatement of the effect on first-amendment rights here is understandable. To state it correctly would require them to address the primary reason for granting certiorari: the conflict with *Hudson* and *Ellis*, 466 U.S. at 443-44, created by the failure of the court of appeals to hold the unions' procedures unconstitutional, because there are readily available alternative means, which would better protect the first-amendment rights of nonmembers, of (1) independently verifying the calculation of the fee before it is collected and (2) selecting an impartial decisionmaker to hear nonmembers' challenges to that calculation. *See* Petition at 8-20.

Instead of trying to reconcile the ruling below as to verification with the less-restrictive-alternative test applied in *Hudson* and *Ellis*, the unions argue that "there is nothing in footnote 18" of *Hudson* to suggest that an independent auditor must "verify the union's breakdown between legally chargeable and legally nonchargeable expenditures." Opposition at 12. However, the holding of *Hudson*, 475 U.S. at 306-07 & n.18, that adequate dis-

closure of "the basis for the proportionate share" charged nonmembers "surely would include * * * verification by an independent auditor," does not stand alone.

Footnote 18 is part of *Hudson*'s ruling that the disclosure must "identif[y] the expenditures for collective bargaining and contract administration." *Id.* at 306-07. Thus, even if only the footnote's immediate context is considered, it is the identification of expenses as chargeable or not which must be independently verified, not "the actual amount of expenditures in each of the union's 'major categories of expenses,' " Opposition at 12, in its basic financial statements. *Hohe v. Casey*, 727 F. Supp. 163, 167 (M.D. Pa. 1989).

Moreover, *Hudson*, 475 U.S. at 309 (emphasis added), characterizes the goal of disclosure—and thus the audit—as "to provide adequate *justification* for the advance reduction of dues." If the reduction is to be "appropriately justified," *id.*, "an independent audit" must verify the portion of dues that would "unquestionably" be spent for nonchargeable purposes. *Tierney v. City of Toledo*, 824 F.2d 1497, 1503-04 (6th Cir. 1987); *see Damiano v. Matish*, 830 F.2d 1363, 1369-70 (6th Cir. 1987).[1] *Hudson*, 475 U.S. at 310 (emphasis added), also describes the independent verification as "a *certified public accountant's* [*not* the union's] verified *breakdown* of expenditures."

To support the argument that the categories of expenses which the auditor must verify are different information from the identification of chargeable and nonchargeable expenses, the unions take out of context a series of comments in *Hudson*. *See* Opposition at 10, 12. The Court may have intended a "limited notice require-

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[1] The *Hudson* audit thus serves two purposes: to give nonmembers sufficient information to decide whether to object to the amount of the fee *and* reduce the risk that the fee collected from objectors might include costs that are not constitutionally chargeable to them.

ment" which would "not impose an undue burden on the union," but it *also* held that the information must be "sufficient to satisfy the First Amendment concerns in this context." *Id.* at 306 n.17. The union "need not provide nonmembers with an exhaustive and detailed list of all its expenditures," because *the independent auditor* will have reviewed the individual expenses in verifying the union's calculation of the chargeable portion of its total annual expenditures. *Id.* at 307 n.18. And, that " '[a]bsolute precision' in the calculation of the charge to nonmembers cannot be 'expected or required,' " *id.* (quoting *Railway Clerks v. Allen*, 373 U.S. 113, 122 (1963)), does not mean that little precision is necessary. As the district court held in this case, only "a limited amount of imprecision is tolerable in calculating a service fee." App. D at 88a; *see Damiano*, 830 F.2d at 1369.

While not as part of a less-restrictive-alternative analysis, the unions argue that auditors cannot "verify the union's breakdown between legally chargeable and legally nonchargeable expenditures," because that "would require a *financial* expert * * * to make a *legal* judgment." Opposition at 12-13. Their argument quotes from accounting texts to the general effect that the " 'expertise of most auditors is limited to laws and regulations that are financial in nature, . . . [and] [a]uditors generally do not have the background and training to evaluate the degree to which an enterprise conforms to * * * other laws and regulations * * * .' " *Id.* at 13 n.6 (quoting, *e.g.*, *Montgomery's Auditing* 22-23 (10th ed. 1985)).

The unions confuse the auditor's role with that of the impartial decisionmaker. The auditor can and should evaluate whether the unions can cite definitive legal authority which clearly supports their allocation of an expense category as chargeable, or only undefinitive or ambiguous authority, in which event the expenses should be disclosed to nonmembers as disputable. That is a

factual, not legal, question.[2] On the other hand, whether disputable expenses are chargeable as a matter of law is a legal question for the impartial decisionmaker.

The only evidence on this issue, which the unions ignore, is the professional opinions of two accounting experts that the legal criteria for a service fee are of the kind that auditors can evaluate. Irving B. Ross, a certified public accountant who was qualified as an expert in both *Communications Workers v. Beck*, 487 U.S. 735 (1988),[3] and *Ellis*, stated "that an independent Certified Public Accountant would normally have the necessary background, training and experience" to "use his judgment independently to determine whether the union is in compliance with established legal criteria and is using acceptable standards and methods in performing its calculation." R.260: Ross Affidavit at 3, 7-8 (JA 237, 241-42).

Similarly, David F. Hawkins, a Professor at Harvard University Graduate School of Business Administration,[4] concluded that "there is no doubt that certified public

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[2] For example, an auditor can easily make the *factual* judgment that organizing expenses should not be allocated as clearly chargeable in the disclosure, because *Ellis*, 466 U.S. at 451-53, and the district court here, App. B at 41a-42a, said that they are not chargeable.

[3] The Special Master before whom *Beck* was tried found Ross "to be not only unusually well qualified as a Certified Public Accountant in the particular area of accounting involved in the present case, but also to be objective, truthful and accurate." *Beck v. Communications Workers*, [1980] Daily Lab. Rep. (BNA) No. 166, at D-1, D-5 (D. Md. Aug. 18, 1980) (Master's Report).

[4] Professor Hawkins has taught financial reporting and analysis for 26 years and served on the Financial Accounting Standards Advisory Council and task forces of the Financial Accounting Standards Board. He has received professional awards and honors and written and contributed to many books and publications on financial reporting and analysis of financial reports, including *Corporate Financial Reporting: Text and Cases* (rev. ed. 1977), a leading textbook in the field. R.260: Hawkins Affidavit at 1 & *vita* (JA 266, 288-300).

accountants, without violating their professional standards, can and do make accounting judgments as to what is and what is not a chargeable cost." R.260: Hawkins Affidavit at 5 (JA 270). He explained:

> Unlike many other legal concepts and legal definitions, the issue of the determination, reporting, and auditing of chargeable costs has been clothed in part in accounting concepts by the courts. Since legal considerations have a direct effect on the amounts presented as chargeable costs, * * * the facts of the situation and the standards of the profession demand that an auditor performing a service fee attestation service acquire adequate knowledge of the relevant legal considerations, use this knowledge in the planning and performance of his or her engagement, and, after consulting with appropriate counsel, be prepared to issue a qualified opinion if, in his or her professional judgment, a union fails to adhere to the service fee accounting standards and cost definitions set by the courts.

Id. at 20 (JA 285). Professor Hawkins also said that "[c]ertifed public accountants are particularly well-suited by training and experience to audit a union's determinations of chargeability." *Id.* at 21 (JA 286).

Thus, because a more carefully tailored independent verification of the calculation of the service fee is readily obtainable, the court of appeals' approval of lesser accounting services conflicts with *Hudson* and *Ellis*.

II. THE UNIONS CANNOT BY *IPSE DIXIT* ELIMINATE THE CONFLICT, IDENTIFIED BY THEIR COUNSEL, BETWEEN DECISIONS OF COURTS OF APPEALS ON THE AUDIT ISSUE

The Petition at 21-22 pointed out that in 1987 the unions' counsel of record identified a conflict, worthy of this Court's review, between the Sixth Circuit's decision in

Tierney and *Andrews v. Cheshire Education Ass'n*, 829 F.2d 335 (2d Cir. 1987), as to the nature of the audit required by *Hudson*. *See* App. J at 122a-23a. The Opposition is deafeningly silent as to that damaging admission. It also neither explains how *Hohe*, 727 F. Supp. at 167, could cite *Tierney* and *Andrews* as contrary, if they do not conflict, nor mentions that *Antry v. Illinois Educational Labor Relations Board*, 552 N.E.2d 313, 325-26 (Ill. Ct. App. Mar. 15, 1990) (WESTLAW, Ill. Cas.), cited in the Opposition at 14, discusses them as conflicting decisions.

Instead, the unions rely on the fact that in this case and *Gwirtz v. Ohio Education Ass'n*, 887 F.2d 678 (6th Cir. 1989), *cert. denied*, 110 S. Ct. 278 (1990),[5] which followed *Andrews*, panels of the Sixth Circuit treated *Tierney* as consistent on the verification issue. *See* Opposition at 15-16. However, neither the later panels nor the unions can reconcile conflicting decisions after the fact simply by saying that there is no conflict. Any fair comparison of *Tierney*, 824 F.2d at 1503-06, with *Andrews*, 829 F.2d at 339-40, must acknowledge that the two decisions conflict, as the unions' counsel originally conceded.

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[5] The Opposition at 17 n.8 asserts that "the instant Petition presents precisely the same auditing issue" as *Gwirtz*. It does not, because the procedure here on its face does not prescribe even the *Gwirtz*-type accounting. *See* Petition at 10-11. The unions argue that petitioners seek to relitigate factual findings that their procedure requires verification as defined in *Gwirtz*. *See* Opposition at 10-11. However, what the unions describe as factual findings are only *assumptions* of the lower courts, unsupported by record evidence (significantly, the unions cite none), that the verification would necessarily be more than what the procedure says on its face. On first-amendment issues, this Court cannot defer to findings, much less assumptions, of lower courts, but must examine the entire record anew. *Rankin v. McPherson*, 483 U.S. 378, 384-86 & n.9 (1987).

III. THE UNIONS MISCHARACTERIZE THE NATURE OF ARBITRATION AND THE RECORD, AND IGNORE READILY AVAILABLE, FAIRER ALTERNATIVES TO THE AAA'S SCHEME FOR SELECTING AN IMPARTIAL DECISIONMAKER

The unions say that *Hudson* "held * * * that 'expeditious arbitration' would be sufficient" to provide nonmembers an opportunity to challenge the service fee before an impartial decisionmaker. Opposition at 17 (quoting *Hudson*, 475 U.S. at 308 n.21). In fact, *Hudson*, 475 U.S. at 308 n.21 (emphasis added), did not *hold* that arbitration would be sufficient, but only said in *dicta* "that an expeditious arbitration *might* satisfy the requirement of a reasonably prompt decision by an impartial decisionmaker."

Moreover, a scheme like that here, where one party to a dispute *unilaterally* selects a third party which chooses the decisionmaker, is *not* arbitration. "By definition, an arbitrator must be a person chosen by mutual agreement." The "essential element of arbitration" is "that the selection of the particular arbitrator or the method of selection of an arbitrator be established by mutual agreement between the parties." *Bethlehem Mines Corp. v. Mine Workers*, 344 F. Supp. 1161, 1165 (W.D. Pa. 1972), *aff'd*, 494 F.2d 726 (3d Cir. 1974). Because a "party's right to choose an arbitrator is * * * an important one," *McKinley v. Martin*, 722 F. Supp. 697, 703 (D. Wyo. 1989), it "is fundamental that one cannot be compelled to submit a matter to arbitration before a particular individual where there is no agreement as to the method by which that individual is chosen." *Bethlehem Mines*, 344 F. Supp. at 1165.[6]

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[6] The texts cited in *Hudson*, 475 U.S. at 308 n.21, do not approve of *unilateral* selection of the American Arbitration Association ("AAA") to name arbitrators. They only say that a "common method of selecting an arbitrator is *an agreement* to utilize the services of" an outside agency such as the AAA. -O. Fairweather, *Practice and*

In arguing that the evidence as to the AAA's selection scheme "says nothing about the impartiality of any particular arbitrator selected by the AAA," the Opposition at 20 n.9 is disingenuous. It is immaterial that AAA's "Board of Directors itself plays no role whatsoever in selecting arbitrators," *id.* The point is that an unacceptable "probability of unfairness," *In re Murchison*, 349 U.S. 133, 136 (1955), is shown by the evidence of the union representation on the Board that governs the AAA, the bias of the staff who selected the special pool from which arbitrators are chosen for union fee disputes, R.260: Deposition of Robert Coulson at 133, 136-37 (JA 366, 369-70), and, most importantly, the AAA's criteria that members of that pool must have been *recommended and regularly employed by unions* in labor-management disputes, *see id.* at 132, 150-51 (JA 365, 377-78).[7]

Equally fundamental is the fact, ignored by the unions, that unlike the AAA's general rules, its special rules for service-fee disputes neither require it to disclose circumstances that create an appearance of bias *to nonmembers* nor permit them peremptorily to disqualify a decision-maker, but leave disqualification to the *discretion of the AAA*. *Compare* App. I, 121a, *with Commonwealth Coatings*

Procedure in Labor Arbitration 82 (2d ed. 1983) (emphasis added); *accord* F. Elkouri & E. Elkouri, *How Arbitration Works* 136 (4th ed. 1985) (an "agreement may designate * * * the AAA" to make a "direct appointment"). Elkouri, at 135, also says, "[n]o part of the arbitration process is more important than that of selecting the person who is to render the decision," and "selection by mutual agreement of the parties is the most desirable method."

[7] Also, while admitting that union attorneys had a "concrete" part in developing the AAA's rules, the Opposition at 20 n.9 misleadingly says that "nonunion employees and their representatives * * * also were involved." In fact, the only role permitted nonmembers and their representatives was letters, ignored by the AAA, criticizing the first draft of the rules, while the AAA's President met twice with union attorneys about the rules. *See* R.260: Coulson Deposition at 115-34, Exs. 5, 8-9 (JA 348-67, 393-404).

Corp. v. Continental Casualty Co., 393 U.S. 145, 149 (1968). Such an arrangement was held to violate due process in *Rogers v. Schering Corp.*, 165 F. Supp. 295 (D.N.J. 1958), *aff'd per curiam*, 271 F.2d 266 (3d Cir. 1959) (affirmed on the district court's "succinct and careful opinion"), a case cited by *Commonwealth Coatings*, 393 U.S. at 148 (equating constitutional and arbitration due process).

In *Rogers*, a prospective replacement arbitrator informed the AAA that he had done business with one party to a dispute. Interpreting its rules as not requiring disclosure to the parties of circumstances bearing on whether there is a presumption of bias when it fills a vacancy, and concluding that the facts did not require disqualification, the AAA permitted the arbitration to proceed without disclosing the replacement's prior employment to the other party. The court vacated the award as "evidently partial" for reasons that apply here:

> [Wh]en the Association is informed by a prospective arbitrator * * * of circumstances which are "likely to create a presumption of bias," *nothing less than a prompt communication of such disclosure to the parties * * * provides the affected party with an opportunity to challenge "for cause."* Nor is it sufficient for the Association to take the position that it weighed the disclosure and concluded that it did not affect the eligibility of the proposed arbitrator. * * * The party may well have a sensitivity to the disclosure not realized by the appointing authority, and * * * it should not be deprived of at least the opportunity to convince the appointing authority of the desirability of selecting a replacement * * * .

165 F. Supp. at 300 (emphasis altered). The court explained that the failure of the AAA to communicate the disclosure to all parties was "more than a loose procedural informality. *It goes to the heart of a body designed to resolve controversy—its integrity. In this instance, it fails to*

protect what might be termed 'due arbitration process.' " *Id.* at 301 (emphasis added).

Given the defects of the AAA's scheme, the unions' procedures are unconstitutional under *Hudson* and *Ellis* unless there are no readily available and fairer alternative means of selecting an impartial decisionmaker. The Petition at 15 suggested two, "mutual selection by the union and nonmembers or representatives of their interests, *e.g.*, the National Right to Work Legal Defense Foundation," and "appointment by a government agency, *e.g.*, the Federal Mediation and Conciliation Service or a state labor agency."

The unions argue that mutual selection is "functionally impossible," because "no single representative would have the authority to select an arbitrator on behalf of all objecting nonmembers." Opposition at 19. However, if the unions can unilaterally designate the AAA to name a decisionmaker, they can designate a representative of nonmembers to participate in mutual selection. The unions do not even try to argue that appointment could not be by a government agency. Thus, because there are at least two readily available, fairer alternatives to direct appointment by the AAA, the decision below upholding that scheme conflicts with *Hudson* and *Ellis*.

IV. CONCLUSION

The petition should be granted as to both questions.

Respectfully submitted,

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